Foreign Investment in the United States— A Danger to Our Welfare and Sovereignty?

by ANATOL BALBACH

FOR MANY years we have heard bitter debate about U.S. investments abroad. From Canada, South America, Europe, and Asia came serious complaints that U.S. capital was taking over their industries and draining their economies of resources. Now, with an apparently significant increase in foreign investment in the United States, sounds of alarm are beginning to be heard from our own businessmen and politicians. We have read that Japanese purchases of hotels, lumber stands, and land are contributing to shortages and inflation. We hear that our "need" for Middle Eastern oil is such that the oil-rich countries will eventually accumulate enough dollars to purchase and, in turn, control our industry.

The purpose of this note is to examine the impact of foreign investment on inflation and welfare, and to assess the probability of a foreign takeover of American industry. The analysis is addressed only to the investment aspect of foreign trade and not to the impact of transactions in current goods and services. Furthermore, it is assumed that all transactions are undertaken by individual decision makers who are interested in maximizing their profits or wealth rather than by governments for strategic or tactical purposes.

Does Foreign Investment Increase Our Cost of Living?

First, let us discuss the question of whether increased foreign investment causes inflationary pressures and whether it has been a factor in the recent dramatic increase in consumer prices. To be consistent with the events of the past several years, this issue should be analyzed under two conditions: one in which foreigners have no accumulated dollar assets and, as is the case now, one in which they do.

If foreigners did not have accumulated dollar balances and wished to buy a capital asset in the United States, they would first have to acquire dollars. In order to do this they would have to sell an equivalent amount of goods to U.S. residents. As a result of this process, the dollar holdings of U.S. residents who bought the imports would decline, and those of foreigners would increase. In turn, as these foreign dollar balances were drawn down, those of U.S. residents who sold capital assets would increase. The U.S. money stock would remain the same; thus there would be no reason to expect additional spending and additional inflationary pressure. To be sure, the prices of the capital assets demanded would have a tendency to increase. On the other hand, Americans would have been induced to import more only if the prices of these imported goods were lower than prices of similar goods produced domestically.

Furthermore, consider the welfare implications of these events. We would have traded some claims on capital assets for some goods or services and, in the process, some prices would have changed. Presumably, trade was entered into willingly by those involved because they found it profitable or because it increased their satisfaction. Thus, even if there was a relative increase in some prices, society would still be better off than it was prior to the trade.

Now consider the situation in which foreigners have accumulated dollar assets from trades in the past. What is the *current* impact of foreign investment? If, as has been common practice, this dollar accumulation by foreigners is held in the form of U.S. Treasury securities, then these securities would have to be sold. The dollar balances of the securities buyers would decline and those of the sellers of claims on capital assets would increase. Again, this action alone would not increase our money stock and, hence, would not be a source of inflationary pressures. The prices of claims on capital assets demanded by foreigners would have a tendency to rise while the prices of the Treasury securities they are selling would tend to decline.

If, however, these accumulated balances were held in the form of foreign central bank balances at the Federal Reserve Banks, then the spending of these balances would increase the money stock and add fuel to inflationary pressures in the United States. In fact, this is not likely to occur; these central bank balances are relatively small and are usually maintained at a relatively stable level for use in day-to-day transactions. A significant reduction of these balances, in view of their small size as compared to foreign holdings of Treasury bills, is highly unlikely. Therefore, even if foreign investment were to continue to increase at the rapid pace exhibited in the past several months, its impact on inflation would be negligible. And since this investment is undertaken voluntarily by all the trading partners, we must presume that it will benefit society as a whole.

Can Foreigners Gain "Control" of U.S. Industry?

Another frequently heard argument is that because of our insatiable desire for oil, foreign oil producers will accumulate vast dollar reserves with which they will buy up U.S. industry and eventually control our productive facilities. We can interpret this statement in the following way: (1) *irrespective of price* we will keep buying the same or increasing amounts of oil from Middle Eastern producers; (2) these producer countries will buy goods and services from the United States at a rate which will be a relatively stable proportion of their oil revenues; (3) the remaining "surplus" will be spent on U.S. productive assets *irrespective of their price;* and (4) foreign "control" of these assets would somehow be "bad."

Suppose for a moment, as improbable as it may be, that we were to buy foreign oil at a rate like that postulated above, and that all of the surplus revenue earned by foreign oil producing countries was spent on investments in the United States. If this continued into infinity, and the U.S. economy grew at a slower rate than our purchases of oil, it would be theoretically possible for Middle Eastern oil producers to gain "control" of our industry. Whether this "control" would be good or bad is not at all clear. As we have discussed previously, such transactions ultimately amount to a voluntary exchange of our productive asset ownership for foreign oil. This exchange, if undertaken by individuals and in the absence of coercion, must be economically beneficial to them.

But what about the future? So long as our industry produces all the goods and services that we are willing to purchase, why should we be so concerned about ownership? If foreign ownership is undesirable from the political point of view, or from a strategic point of view during a war, foreign owners could be controlled by legal sanctions. But there are no economic grounds for the evaluation of foreign versus domestic ownership. Besides, if the sellers of these domestic assets still wished to own income-producing goods, and if these goods were too expensive at home because of foreign demand, they could buy foreign assets, perhaps even exploratory rights of oil fields abroad. But such speculation about what could happen and about the welfare implications of foreign ownership is not very realistic; we should really take a look at the possibility of such foreign capital invasion occurring even under the very pessimistic assumptions made above.

Let us speculate on how large this foreign investment in the United States could be and whether it could give foreigners "control" over our industry. We can proceed with the previously made interpretations of the argument which will yield the strongest case for it.

Chart I

Bilateral Trade Balance Projections

United States — Oil Producers in the Eastern Hemisphere

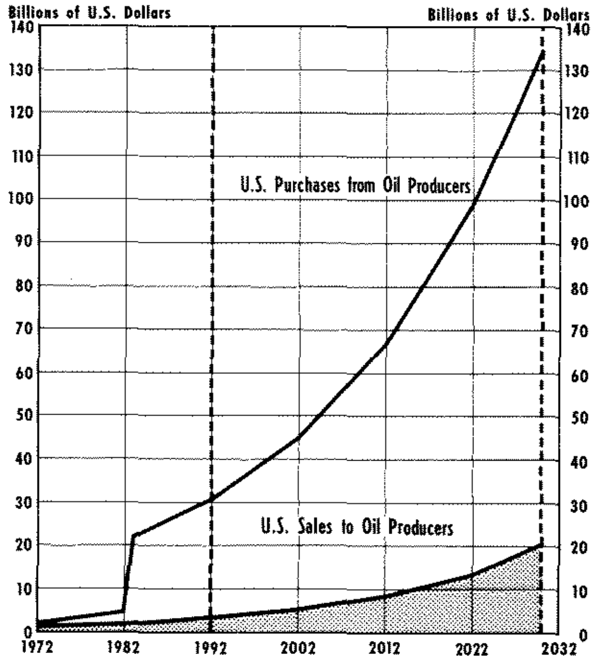
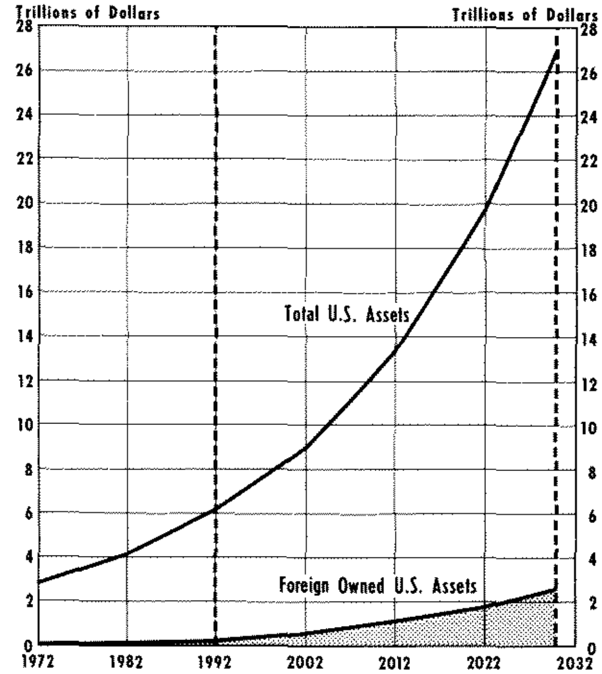


Chart II

Projections of U.S. Non-Human Wealth and Asset Accumulation by Oil Producers



Estimates have been made that U.S. oil reserves will be depleted in 10 years and Middle Eastern and North African reserves in 60 years.[1] Let us assume that our oil consumption would rise at a constant rate associated with the growth of our real GNP and that after 10 years our domestic oil output would have to be fully supplanted by greater imports from the Middle East and North Africa. Let us further assume that their imports from the United States would rise at, say, 5 percent per year, and that the remaining dollar surplus would be spent buying capital assets in the United States. Trade between Middle Eastern countries and the world outside of the United States is excluded from consideration because such trade, in relation to the investment in the United States, would set off repercussions on the exchange rate which would violate our assumption of price constancy.

Chart I shows the projected U.S. imports of oil from the Eastern Hemisphere and the projected U.S. exports to these countries. The projections are based on the assumption that U.S. oil consumption will remain at 0.7 percent[2] of our real GNP which will rise at a 4 percent annual rate. Further, it is assumed that the exports of U.S. goods and services to oil producing countries will rise at 5 percent per annum, and that the Western Hemisphere's oil reserves will be depleted in 10 years. The cumulative difference between U.S. oil imports and U.S. exports to oil-producing countries is assumed to be the amount of foreign dollar accumulation which is then invested in the ownership of U.S. industry.[3]

Chart II shows projections of the growth of non-human assets in the United States and projected accumulation of U.S. assets by foreigners resulting from import-export activities depicted in Chart I. The U.S. asset growth is simply the projected GNP multiplied by a factor of 3.5, which assumes that approximately 28 percent of our total factors of production will consist of non-human assets. All of the assumptions are admittedly simplistic yet not unreasonable.

There are two points in time that we should be concerned with – 1992 and 2030. One estimate of the Eastern Hemisphere's oil supply is 250 billion barrels.[4] Another one states that this supply will run out

[1]See Walter J. Levy, "Oil Power," *Foreign Affairs* (July 1971), p. 653.

[2]This percentage has prevailed for the past 10 years.

[3]It is assumed that: U.S. oil production will remain constant (4.1 billion barrels per year), due to limits on the refining capacity, until U.S. reserves are depleted; oil reserves in the Western Hemisphere will be depleted at the same time as U.S. reserves; and the price will remain at $2.50 per barrel.

[4]"Tankers that Move the Oil that Moves the World," *Fortune* (September 1, 1967).

in 60 years.[5] If we take the first estimate and assume that our projected U.S. oil consumption is one-half of total world oil consumption, then the reserves will be used up in 1992. The other estimate puts us in the year 2030.

As can be seen in Chart II, in 1992 the value of our non-human productive assets would be $6,100 billion and the maximum accumulation of foreign-owned assets would reach $232 billion or 3.8 percent. If we consider the year 2030, the value of assets would reach $26,900 billion and foreign ownership $2,600 billion or 9.6 percent. In either case it would not produce foreign "control" of our industry.

This simple exercise is not intended to make accurate predictions into the future. Some reasonable assumptions of growth have been made and constant prices and exchange rates have been presumed. Increases in prices of traded assets may tend to narrow the accumulation of dollar reserves. Thus, the case presented here tends to overstate the possible acquisition of U.S. assets by foreigners. Even under these pessimistic circumstances the assertion of foreign control of U.S. industry becomes ridiculous.

[5]Levy, "Oil Power," p. 653.